if at all, the States could restructure an ITC to survive the Sixth Circuit's misguided dormant Commerce Clause analysis.

Second, the particular dynamics of this issue show that not only is review needed, but it is needed *now*. While percolation in the lower courts is useful in most cases, any delay in resolving the issue here will result in irreparable harm. The decision below disables Ohio (and its sister States in the Sixth Circuit) from competing on an even footing for business investment dollars. Virtually all States offer some form of ITC, and the forty-six States outside the Sixth Circuit remain free to do so. This is no small matter; Ohio development officials estimate that, since 1995, businesses have invested over *$30 billion* in Ohio alone in reliance on the ITC, money that could have just as easily gone to another State or another country. When other States in the circuit are considered, the numbers become truly staggering. Ohio believes that the ruling below is erroneous. But whether it is or not, national uniformity on this issue is absolutely necessary to ensure a level playing field among the States in their attempts to attract investment. Only this Court can provide that uniformity, and Ohio urges the Court to do so sooner rather than later.

Further confirming the importance of immediate review, not only does the ruling irreparably harm Ohio in its competition with its sister States, but the broad language of the court's opinion harms States throughout the country. Because the court's ruling does not supply any ready limiting principle, it casts a constitutional shadow over ITCs in every State. Indeed, the academic commentators on whose theory the court below relied, see Cuno Cert. App. 13 n.1, specifically aver that "[t]he constitutionality of the vast majority of income tax credits in this country cannot be persuasively defended." W. Hellerstein & D. Coenen, *Commerce Clause Restraints on States Business Development Incentives*, 81 Cornell L. Rev. 789, 818 (1996).

Thus, all States that rely on an ITC to attract development may find their efforts compromised as manufacturers elect to go elsewhere, perhaps even overseas. And given the nature of such decisions, even a temporary cloud can have long-lasting effects. Plants and equipment, once installed, are not easily relocated. Thus clarity, as well as uniformity, is absolutely vital, and must be achieved quickly.

Finally, in our federalist system, the Court bears the responsibility for policing the appropriate boundaries of federal power, and preventing the lower federal courts from improperly encroaching on the State sovereigns. The decision below strikes a devastating blow to the States' sovereign right to control their economic development and taxation policies, two undeniably vital issues to any State. As this Court itself has recognized, "the taxation authority of state government" is "central to state sovereignty." *Dep't of Revenue v. ACF Indus.*, 510 U.S. 332, 345 (1994). Thus, lower court decisions curtailing that authority merit special attention. Moreover, the need for review is particularly pressing where, as here, the lower court has *erroneously* constricted that authority. This Court itself has emphasized that States are free to structure their "tax systems to encourage the growth and development of intrastate commerce and industry." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977). The court below improperly interfered with Ohio's attempts to do so. Accordingly, Ohio respectfully urges the Court to review the decision below, and reverse the judgment invalidating the ITC.

STATEMENT OF THE CASE

A. The plaintiffs below challenged two tax incentives that Ohio uses to attract business investment.

This case began as a challenge to two different locational tax incentives that Ohio and its cities use to attract

business investment dollars. The first is a credit against the corporate franchise tax; this credit is called the investment tax credit or ITC. The second is a property tax exemption. Both are based on a business's new investment in Ohio. The State and the City of Toledo offered these incentives as part of a deal for DaimlerChrysler to expand its plant in that city. The plaintiffs all claim that offering the ITC to DaimlerChrysler harmed them in some way. Several of the plaintiffs are Ohio taxpayers who claim the tax breaks have unjustifiably depleted public revenue. Others are Michigan taxpayers, who claim that the failure to locate the Jeep plant in Michigan depleted Michigan revenues. And there is also an entity, Kim's Auto, that asserts that the tax incentives resulted in the acquisition of Kim's property through eminent domain for DaimlerChrysler's plant expansion.

The plaintiffs originally sued in the Court of Common Pleas of Lucas County, Ohio. The complaint asserted challenges to both the ITC and the property tax exemption, including challenges based on the Commerce Clause and on state equal protection guarantees. The complaint named as defendants DaimlerChrysler Corp., the City of Toledo, two school districts in the City of Toledo,[2] various local officials and the State defendants.

As the complaint included a federal claim, the defendants removed the action under 28 U.S.C. § 1441 to the United States District Court for the Northern District of Ohio. Plaintiffs sought to have the action remanded to state court, but the district court denied that motion. Defendants then moved to dismiss plaintiffs' claims for failure to state a claim. On August 1, 2001, the district court dismissed all claims.

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[2] Under Ohio law, a company can receive a property tax exemption greater than 75% only if the local school districts agree. Here, the local school districts agreed, which was apparently the basis for including them as defendants in the lawsuit.

Plaintiffs appealed to the United States Court of Appeals for the Sixth Circuit. That court reversed in part and affirmed in part. In particular, the court upheld the dismissal of the property tax exemption claims. On the ITC, however, the court reversed the district court's dismissal order. It then went even further and entered judgment on plaintiffs' behalf, finding that the ITC violated the dormant Commerce Clause. This petition seeks review of the Sixth Circuit's judgment on the ITC issue.

B. The tax incentive at issue here is a credit that Ohio offers against its corporate franchise tax for new in-state business investment.

The tax provision underlying this petition allows businesses to take a credit against their Ohio corporate franchise tax. See Ohio Rev. Code ("O.R.C.") § 5733.33. Thus, an understanding of the ITC issue requires a brief explanation of both the corporate franchise tax and the credit that the ITC provides against that tax.

a. Ohio's corporate franchise tax is "an excise tax levied on corporations for the privilege of doing business in this state, owning or using a part or all of its capital or property in this state, or holding a certificate of compliance authorizing it to do business in this state." *Wesnovtek Corp. v. Wilkins*, 825 N.E.2d 1099, 1100 (Ohio 2005); see also O.R.C. § 5733.01(A) (the corporate franchise tax statute). The corporate franchise tax aims "to tax the fair value of business done in Ohio." *Rio Indal, Inc. v. Lindley*, 405 N.E.2d 291, 292 (Ohio 1980), and it does so by requiring calculation "on both a net-worth and a net-income basis," such that "[t]he calculation that produces the greater amount of tax is used as the basis to levy the tax," *Wesnovtek Corp.*, 825 N.E.2d at 1100.

With respect to interstate businesses, Ohio seeks to "measure the extent of a corporation's Ohio business activity" by a method under which "certain types of income

are allocated, and other income is apportioned." *Id.* "Allocation" refers to "attribution to a particular jurisdiction of income from a given source, usually because the asset that is the source of that income is located in that jurisdiction." *Id.* "Apportionment" involves "divid[ing] income from interstate activity that is not allocated to a definite situs by using a formula based upon several factors." *Id.* (quotation marks omitted). That is, they are two different, but related, ways of determining what portion of a multi-state business's assets and revenues are appropriately subject to taxation in Ohio as opposed to some other State or country.

Under Ohio tax law, a corporation's "business income" is apportioned through use of a three-factor formula. That formula determines the percentage of a company's property, payroll and sales that are attributable to Ohio, and Ohio then applies its taxes to that percentage of the company's income. O.R.C. § 5733.05(B).[3] This is similar to the way most States apportion income for tax purposes. Indeed, the Court has noted that the three-factor apportionment formula has become "something of a benchmark against which other apportionment formulas are judged." *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983).

Under this approach, two effects are evident. First, an interstate business that installs "new manufacturing machinery and equipment" in an Ohio location and operates that installation as part of its interstate business will typically increase the exposure of its interstate net worth or its interstate net income to Ohio's corporate franchise tax. The new investment increases the Ohio property factor as well as

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[3] The Ohio General Assembly is currently considering repealing the corporate franchise tax and replacing the revenue stream through other forms of taxes. Even if that occurs, however, the claims here retain their vitality in light of the millions of dollars of credits that DaimlerChrysler and hundreds of other corporation taxpayers have either claimed on their current year returns, or asserted through pending claims that seek refunds of taxes previously paid.

the Ohio payroll factor (if new employees are hired), thus increasing the amount of income apportioned to Ohio for purposes of Ohio's taxes.

The second effect on an interstate business is the mirror image of the first. If an interstate business elects to locate new manufacturing machinery and equipment *outside* Ohio, its Ohio percentage will decrease. That is, the amount of the company's property and (probably) payroll outside the state increase, making the Ohio portion a smaller percentage of the whole. The result: the company's overall exposure to Ohio's corporate franchise tax will decrease, just as locating in Ohio increased its exposure.

In short, any new investment, either inside or outside the State, will have tax consequences in Ohio, just as it will have tax consequences in any other State that uses this common "benchmark" apportionment formula.

b. The ITC at issue here is a credit against the corporate franchise tax described above. The credit is generally available to all corporate taxpayers in Ohio, but it is triggered by the corporation's investment in "new manufacturing machinery and equipment" that the corporation installs in Ohio.

The size of the credit the taxpayer receives is set at a percentage of the qualifying investment the taxpayer makes during a given year. The usual percentage is seven and one-half percent. So, for example, if a business made a $1 million qualifying investment in Ohio, it would receive a tax credit of $75,000 against the corporate franchise tax it owes the State.

To limit the credit to truly *new* investment, the ITC applies only to the amount by which the investment in a given year exceeds the average investment by that same taxpayer in that same county during earlier baseline years. O.R.C. §§ 5733.33(C)(1), (A)(15). If, for example, a taxpayer

had been investing $3 million per year in its plants in a given county during the baseline years, and then made a $5 million investment, the tax credit would be based only on the $2 million amount by which the new investment exceeded the baseline. In other words, a taxpayer who has previously invested in the same county receives a lesser credit for additional investments than one who has never invested in the county.

If the investment is made in an "eligible area," the percentage is not seven and one-half but rather thirteen and one-half. O.R.C. § 5733.33(C)(2). Eligible areas are those that the Ohio Department of Development determines, under criteria set forth in the statute, to be a "distressed area," a "labor surplus area," or a "situational distress area." O.R.C. § 5733.33(A)(9). DaimlerChrysler's investment here was in an "eligible area."

The ITC is a nonrefundable credit. That is, it can be used only to offset a tax liability; the taxpayer does not receive payment from Ohio for the unused portion of the credit. The statute provides, though, that the credit will be spread over seven tax years. Thus, one-seventh of the amount of credit attributable to an investment made in "year one" is available in each of the seven years after the investment. O.R.C. § 5733.33(C)(4). The statute also permits a three-year carry-forward of otherwise untaken increments of the credit. O.R.C. § 5733.33(D). Thus, the statute effectively allows the taxpayer to spread the credit for a particular investment over a ten-year period.

C. The district court determined that the ITC was not discriminatory and did not violate the dormant Commerce Clause.

As noted above, the plaintiffs here asserted that the ITC, along with a property tax exemption that was similarly triggered by in-state investment, violated the dormant Commerce Clause. After removal, the district court

dismissed the plaintiffs' claims. In doing so, the district court noted this Court's pronouncements that States are not prevented "from structuring their tax systems to encourage the growth and development of interstate commerce and industry," and that competition among the States "lies at the heart of a free trade policy." Cuno Cert. App. 31 (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336–37 (1977)). Indeed, as the district court also noted, this Court has stated that it is "a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing State." Cuno Cert. App. 32 (quoting *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 385 (1991)).

Given the important economic goals that States can pursue through their tax structures, the district court recognized that this Court's jurisprudence has struck state taxes on dormant Commerce Clause grounds in only two categories of cases. First, the Court has struck those taxes that act as a "protective tariff or customs duty." Cuno Cert. App. 32 (quoting *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994)). Second, the Court has struck tax credits and exemptions that turn on the level of activity *outside* the state. Cuno Cert. App. 33 (citing *Westinghouse Elec. Co. v. Tully*, 466 U.S. 388 (1984)).

The district court determined that Ohio's ITC fell in neither camp. With regard to the first, the court found that the ITC is not a tariff or duty, as "it does not burden in the slightest the transfer of goods in interstate commerce," and "it is available equally to businesses regardless of their initial location, so long as they increase the amount of their Ohio investment." Cuno Cert. App. 33. As to the second, the court correctly noted that "neither the credit nor the [property tax] exemption varies with increased activity outside Ohio." *Id.* Accordingly, the district court determined that "[f]inding either scheme unconstitutional would therefore require this

Court to violate the clear mandate of Supreme Court precedent," which it declined to do. *Id.* at 34.

D. The Sixth Circuit concluded that although the ITC is equally available to in-state and out-of-state business, the ITC nonetheless discriminates on its face against interstate commerce.

The Sixth Circuit took a different tack. It began by noting that the "United States Supreme Court has never precisely delineated the scope of the doctrine that bars discriminatory taxes." Cuno Cert. App. 6. Turning to the matter at hand, the court expressly acknowledged that "the investment tax credit at issue here is equally available to in-state and out-of-state businesses." *Id.* at 7. Nonetheless, it concluded that the tax credit discriminated against interstate commerce. In particular, it accepted the plaintiffs' argument that "the economic effect of the Ohio investment tax credit is to encourage further investment in-state at the expense of development in other states and that the result is to hinder free trade among the states." *Id.* at 11.

In arriving at that conclusion, the court first rejected the principle that "the Commerce Clause is primarily concerned with preventing economic protectionism," *id.*, a principle the defendants had advanced based on this Court's precedent. See, e.g., *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996) ("the Commerce Clause prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors") (quotation marks omitted). Then, having shorn the dormant Commerce Clause from its anti-protectionist moorings, the court also rejected the defendants' tax arguments, which had relied on that principle. In particular, the defendants had argued that the anti-protectionist principle meant that tax credits and exemptions "would run afoul of the Commerce Clause" primarily in two categories: "those that function like a tariff by placing a higher tax upon out-of-state business or

products and those that penalize out-of-state economic activity by relying on both the taxpayer's in-state and out-of-state activities to determine the taxpayer's effective tax rate." Cuno Cert. App. 11.

The court admitted that "it is arguably possible to fit certain of the Supreme Court cases into this framework." *Id.* Nonetheless, the lower court rejected that approach: "[W]hile we may be sympathetic to efforts by the City of Toledo to attract industry into its economically depressed areas, we conclude that Ohio's investment tax credit cannot be upheld under the Commerce Clause of the United States Constitution." *Id.* at 13.

Having rejected the argument that the dormant Commerce Clause's primary focus is preventing protectionism, and that challenges to state taxes should be assessed in that light, the court failed to clearly articulate any other limiting principle. At points, the court seemed to suggest that an ITC would violate the dormant Commerce Clause only if it permitted an in-state taxpayer to reduce an "existing tax liability by locating significant machinery within the state." *Id.* at 7. But at other points the court seemed to adopt the broader argument proffered by the plaintiffs that a tax scheme will violate the dormant Commerce Clause any time it has the "economic effect" of "encourag[ing] further investment in-state at the expense of development in other states." *Id.* at 11.

Because of the exceptional importance of this issue to the States' sovereign right to control both their tax and economic development policies, and to Ohio's ability to compete on equal footing for new business investment, the defendants-appellees sought rehearing en banc. The court denied that request,[4] and this petition followed.

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[4] In Ohio's petition for rehearing, Ohio asserted that the case had become moot after argument but before the Sixth Circuit issued its opinion

REASONS FOR GRANTING REVIEW

A. The decision below creates confusion regarding the interaction between the dormant Commerce Clause and state tax credits.

As the court below noted, this Court "has never precisely delineated the scope of the doctrine that bars discriminatory taxes." Cuno Cert. App. 6. Indeed, the Court itself has observed that its jurisprudence in this area "has left much room for controversy and confusion and [provided] little in the way of precise guides to the States in the exercise of their indispensable power of taxation." *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 403 (1984). Sadly, the decision below further clouds this already murky, but vitally important, area of the law in at least two ways. First, the dormant Commerce Clause analysis the court below used in striking Ohio's ITC directly conflicts with the analysis the Michigan Supreme Court used in upholding a similar Michigan tax incentive. Second, in reaching its result, the lower court both rejected the key principles that animate this Court's dormant Commerce Clause jurisprudence, and failed to clearly articulate the principles it was relying on in their stead.

1. The dormant Commerce Clause view articulated below conflicts with the Michigan Supreme Court's decision in *Caterpillar*.

In *Caterpillar, Inc. v. Michigan Department of Treasury*, 488 N.W.2d 182 (Mich. 1992), the Michigan Supreme Court reviewed a claim that the Michigan Single

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because Kim's Auto, the only plaintiff that Ohio believes ever had standing, had lost its particularized interest in this matter. Accordingly, Ohio asserted that under *United States v. Munsingwear, Inc.*, 240 U.S. 36, 39 (1950), the correct course was to vacate both the appellate decision and the district court decision and dismiss the case. The Sixth Circuit nonetheless denied rehearing en banc, effectively rejecting that argument. Ohio does not press the mootness argument here.

Business Tax's capital acquisition deduction, by virtue of being apportioned differently from the tax base itself, violated the Commerce Clause. The State's highest court accepted the proposition that the deduction was structured in part "to promote investment that will provide jobs and prosperity to the citizens of the taxing State." *Id.* at 192 (quoting *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358 (1991)). It nonetheless upheld the tax scheme, citing this Court's reminder that "[i]t is a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing state." *Id.* According to the Michigan court, because the tax scheme focused on providing benefits for in-state activity, rather than "imposing adverse tax consequences upon multistate taxpayers as a class," it was fine. *Caterpillar, Inc.*, 488 N.W.2d at 193.

That is, the Michigan court expressly relied on the distinction between taxes that *benefit* in-state activity, and those that *burden* out-of-state activity, as a key component of its dormant Commerce Clause analysis. The Sixth Circuit, by contrast expressly rejected as "tenuous" that very distinction. According to the court, "economically speaking, the effect of a tax benefit or burden is the same." Cuno Cert. App. 12. Compare P. Tatarowicz & R. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 Vand. L. Rev. 879 (1986). Of course, the precise tax at issue in *Caterpillar* is arguably distinguishable from the ITC here. For example, *Caterpillar* did not involve a freestanding incentive tax-credit, but rather the incentivizing structure of a deduction that was a logically necessary part of Michigan's unique "Single Business Tax." But the key point for purposes of this petition is that the theories underlying the two decisions are inherently conflicting. And the fact that Michigan is located in the Sixth Circuit just heightens the tension that results from that conflict.

2. In striking Ohio's ITC, the Sixth Circuit rejected the principles underlying the Court's dormant Commerce Clause jurisprudence.

The Court has noted that tax credits are, at least in some situations, an appropriate component of the "competition [among the States] that lies at the heart of a free trade policy." *Westinghouse*, 466 U.S. at 406 n.12 (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336–37 (1977)). But, as explained below, the Court has offered little guidance as to how to differentiate acceptable from unacceptable credits, particularly in the context of credits against a general income tax as opposed to a transactional tax. This case would be an ideal vehicle for providing that guidance. Moreover, while none of the Court's precedent governs the precise context here, the Court has provided general principles for assessing challenges to State taxes. The decision below cannot be squared with those principles, and that further confirms the need for review.

a. The Court has expressly acknowledged that States may use tax incentives—the Court specifically mentioned "job-incentive and investment-tax credits"—to "compete with other States for a share of interstate commerce." *Westinghouse*, 466 U.S. at 406 n.12 (quotation marks omitted). Thus, no one can contest that a State's use of tax incentives to promote local investment is a legitimate state objective, and one that is fully consistent with the dormant Commerce Clause. Accordingly, the mere fact that Ohio's ITC on its face distinguishes investment in Ohio from investments elsewhere cannot by its own force condemn the credit as a discrimination against interstate commerce.

To the extent that the opinion below suggests otherwise, it is simply wrong. In particular, certain portions of the opinion suggest that a credit would violate the dormant Commerce Clause any time it has the "economic effect" of "encourage[ing] further investment in-state at the expense of

development in other States." Cuno Cert. App. at 11. Of course, any locational tax incentive would violate the dormant Commerce Clause under that test. All development in one State comes, to some extent, at the expense of development in another. Taken at face value, then, the decision below cannot be squared with this Court's precedent, and review is warranted to resolve that conflict.

b. Even assuming that the Sixth Circuit did not mean a literal interpretation of the broad language it used, review is still necessary to provide guidance on the line between permissible and impermissible tax incentives in the ITC context. The Court has noted that a State tax violates the dormant Commerce Clause if it "functions by design and on its face to burden out-of-state [interests] disproportionately." *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 579 n.13 (1997). It has provided little guidance, however, on what constitutes a "disproportionate burden."

The need for such guidance is particularly pressing with regard to ITCs like Ohio's. The Court has not yet had the opportunity to address a Commerce Clause challenge to a state corporate franchise or income tax credit, like the one here, that is measured by—and limited to—a specified percentage of the particular amount of newly made investments within the State. Instead, most of the cases in which the Court has applied the Commerce Clause anti-discrimination principle involved *transactional* taxes, not income or corporate franchise taxes. And in that context in-state versus out-of-state distinctions typically involve de facto tariffs that discriminatorily burden interstate commerce, a situation that represents the "paradigmatic example of a law discriminating against interstate commerce." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994).

Moreover, in such cases, the distinction between benefiting in-state activities and burdening out-of-state activities that the Michigan Supreme Court relied on, and the

Sixth Circuit here rejected, largely disappears. *Boston Stock Exchange*, for example, involved a transactional tax break that systematically raised the cost of doing business every time a certain aspect of a stock sale occurred outside the state. In that situation, the in-state benefit was identical to, and indistinguishable from, the out-of-state burden. Thus, the transactional-tax-break cases offer little instruction on the appropriate framework for challenges to income tax credits.

While the Court did consider an income tax provision in *Westinghouse*, supra, that case offers little guidance here. That is because *Westinghouse* did not address a credit measured by a percentage of investment, but rather a credit that simply removed a portion of the tax attributable to a particular income-generating activity—and added an export ratio to the mix that the Court found unconstitutional, see *Westinghouse*, 466 U.S. at 390–95. To be sure, the *Westinghouse* Court found the State's distinction between income-tax credits and transactional tax breaks to be "irrelevant to our analysis," but only because the export ratio in *Westinghouse* had the effect of "placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate." *Id.* at 404. That is, the income tax provision at issue in *Westinghouse*, which was levied on the income derived from in-state transaction, was the functional equivalent of a transactional tax, and one that, by its way of operation, burdened out-of-state transactions.

Indeed, if anything, *Westinghouse* confirms the need for review. In *Westinghouse*, the Court noted the same distinction between benefiting in-state activity, which is largely permissible, and punishing out-of-state activity, which is not. In particular, the *Westinghouse* Court found the tax there unconstitutional because it not only "provide[s] a positive incentive for increased business activity in New York State . . . but also [ ] penalizes increases in . . . shipping activities in other States." 466 U.S. at 401 (quotation marks

omitted). The Michigan Supreme Court followed this Court's lead, making the same distinction in *Caterpillar* to uphold the ITC there. But the court below largely rejected that same distinction. Cuno Cert. App. at 12 (describing the "distinction between laws that benefit in-state activity and laws that burden out-of-state activity" as "tenuous").

In short, the States need a clear roadmap for exercising their "indispensable power of taxation," *Westinghouse*, 466 U.S. at 403, and the Court has not provided one in the context presented here. Ohio accordingly urges the Court to accept this case as a vehicle for providing that clarity.

c. While the Court has not considered the precise ITC context here, the Court has established several general principles to apply to dormant Commerce Clause challenges to state taxes. These broader precedents further confirm the need for review here, as the decision below conflicts with the principles those precedents establish.

Perhaps the key principle animating the Court's dormant Commerce Clause jurisprudence is the notion that "the Commerce Clause prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996) (quotations marks omitted). In the tax context, this focus on anti-protectionism has led the Court to condemn state taxes that fall into either of two categories.

First, the dormant Commerce Clause prevents taxes that act as a tariff. See, e.g., *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 275 (1988) (fuel tax credit tied to amount of ethanol used—but only ethanol produced in Ohio—viewed as erecting "an economic barrier against competition . . . equivalent to a rampart of customs duties") (quotation marks omitted). Indeed, as noted above the "paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported

from other States, but does not tax similar products produced in State." *West Lynn Creamery, Inc.*, 512 U.S. at 193. See also *Boston Stock Exch.*, 429 U.S. at 335–36; *Bacchus Imports. Ltd. v. Dias*, 486 U.S. 263, 267–69 (1984).

Second, the Clause prevents States from erecting taxes that would penalize businesses for out-of-state activity, for example by basing the tax rate for a business's in-state activities on the percentage of out-of-state activity in which the business engages. See *Westinghouse*, supra. In short, States may offer benefits for in-state activity, but they may not do so by disproportionately burdening out-of-state activity.

But unlike the taxes in *Westinghouse* and *New Energy*, Ohio's ITC fully conforms to these dormant Commerce Clause limitations. The ITC does not erect a de facto tariff as did the credit in *New Energy*, for example, because the "new manufacturing machinery and equipment" that qualifies need not be purchased or produced in Ohio. Nor does Ohio's ITC impose a protectionist preference for established Ohio industry on an ongoing basis, because the credit (i) is equally open to all investors whether currently active in or outside Ohio; (ii) is available only for a specific amount of actual investment; (iii) is fully exhausted when that cap is reached; and (iv) ultimately furnishes no continuing benefits to the taxpayer based merely on an Ohio presence.

Similarly, the ITC cannot be said to impose "burdensome taxes on out-of-state" investments. That is so, because unlike the credit in *Westinghouse*, no amount of out-of-state investment reduces the amount of the tax incentive that Ohio awards with respect to in-state investments. And Ohio's ITC—like ITCs generally—does not deny its benefit to outside corporations. In fact, businesses may be *more* likely to spread their investments, as the first dollar "counts" for tax credit purposes during an initial foray into the State, whereas later investment is subject to the baseline limitation

described above. See above at 9–10; see also O.R.C. § 5733.33(C)(1).

The court below reached a different conclusion only because it rejected the Court's fundamental dormant Commerce Clause principles. In particular, it rejected the idea that the dormant Commerce Clause's primary focus is economic protectionism. See Cuno Cert. App. 11. And it rejected the two categories of impermissible taxes that Ohio had identified based on that focus. Moreover the court did so despite acknowledging that "it is arguably possible to fit certain of the Supreme Court's cases into this framework." *Id.*

Further compounding the resulting confusion, the court below, having rejected the Court's dormant Commerce Clause framework, declined to provide one of its own. The opinion gives no workable suggestion as to the permissible limits of tax credits such as the ITC here.

In sum, the decision below conflicts with this Court's general dormant Commerce Clause framework, and thereby creates overwhelming confusion on the vitally important question of whether and to what extent the dormant Commerce Clause permits States to use ITCs. Review is urgently needed to address both that conflict and the resulting confusion.

B. Failure to provide immediate review will cause irreparable harm to Ohio and other States.

Not only is review necessary, it is desperately needed *now*. This is so for at least two reasons. First, the competition among States for business investment dollars is fierce, and the ruling here hamstrings Ohio in its efforts to participate in that struggle. Second, by creating uncertainty regarding ITCs generally, the ruling below irreparably harms States across the county.

1. The lack of a uniform national rule uniquely disadvantages Ohio (and the other Sixth Circuit States) in the competition for business capital.

States compete vigorously with each other, and with foreign countries, in their attempts to secure development dollars. And tax credits are an important part of that fight. Certainly, no one disputes that businesses consider tax issues in making investment decisions. *See* G. Gambale, *19th Annual Corporate Survey*, Area Development Magazine (2004), available at http://www.area-development.com/FrameCorpSurvey4.html (last visited June 16, 2005). That is why States[5] across the country use ITCs to compete for such investment. *Id.* The direct result of the panel decision, however, is that Ohio can no longer do so.

Further compounding the problem is the lack of any clear limiting principle in the opinion. The court sheared the

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[5] Thirty-even States offer investment tax credits that, like Ohio's, are calculated based on capital investment within the State, many of which are part of an enterprise zone program. See, e.g., Ala. Code § 41-23-24; Ark. Code Ann. §§ 15-4-2706, 15-4-1904; Cal. Rev. & Tax. Code § 23649; Fla. Stat. Ann. § 220.191; Ga. Code Ann. § 48-7-40.21; 35 Ill.Comp. Stat. 5/201(f); Ind. Code § 6-3.1-11-16; Iowa Code § 15.333; Kan. Stat. Ann § 79-32, 160a; Me. Rev. Stat. Ann. tit. 36, § 5219-E; Md. Ann. Code art. 83a, § 5-1501; Mass. Gen. Laws ch. 63, § 38N; N.Y. Tax Law § 210(12)(a); N.C. Gen. State. § 105-129.9; Okl. Stat. tit. 68 § 2357.4; S.C. Code Ann. § 12-14-60· Va. Code Ann. § 59.1-280.1. In addition, nine other States offer different credits to their corporate franchise tax, such as investment tax credits that are calculated on a basis other than capital investment and/or credits that are based on the creation of new jobs in the State, credits that Respondents would assert are equally at risk simply by virtue that the credits are granted based on the location of additional resources within the State. See, e.g., Haw. Rev. Stat. § 209E-9; Minn. Stat. § 469.171, subdiv. 1(2); Miss. Code Ann. § 57-73-21; Mont. Code. Ann. § 15-31-134; Or. Rev. Stat. § 317.124. The only States not potentially affected by the Sixth Circuit's decision regarding Ohio's ITC are the four States that have no corporate franchise tax—Nevada, South Dakota, Washington, and Wyoming.

dormant Commerce Clause doctrine from its anti-protectionist moorings, see Cuno Cert. App. 11–13, but put nothing in its place. This leaves Ohio without any meaningful guidance as to how to "fix" its ITC from the lower court's perspective.

The end result is that Ohio, and to some extent the other three States in the Sixth Circuit, are at a substantial disadvantage as compared to all States outside the circuit in their efforts to attract business capital. And this is no small matter. Between 1997 and 2001, Ohio alone granted some $302 million in investment tax credits, representing over $30 billion in new business investment in the State. Tennessee likewise has attracted $17 billion, Michigan $11 billion, and Kentucky $10.8 billion. See Br. of Amici Curiae Mich., Ky., and Tenn. in Support of Rehearing En Banc, at 3–5 (6th Cir. Case No. 01-3690). With the increasingly dynamic flow of business capital, all these investments could have easily gone elsewhere.

Given the uncertainty that the decision creates, businesses facing investment decisions now will be understandably leery of the locational tax incentives these States may offer. Plants may end up elsewhere, causing unnecessary economic dislocation, and stifling Ohio's (and these other States') efforts to grow their economies. And of course, these investment decisions, once made, could have impact for generations to come. Plants, once located, are not easily moved. Moreover, industries often spring up around the selected site providing needed goods and services for the plant. These ripple effects further benefit the chosen State, so the absence of a plant in Ohio carries a concomitantly larger loss than even the above figures reflect. And perhaps most important, these lost dollars represent lost jobs and lost opportunities for Ohio's citizens.

In short, Ohio believes the Sixth Circuit erred in striking the ITC. But, whether the court below erred or not,

review is urgently needed to ensure a uniform national rule. Even if the court below was correct (and of course Ohio does not concede that it was), Ohio deserves the right to compete on a level playing field. Only this Court can secure that right.

2. Uncertainty regarding the constitutionality of locational tax incentives harms States across the country.

Beyond the harm the decision below imposes on Ohio, the decision's broad implications for States across the country further demonstrates the need for immediate review. In holding Ohio's ITC unconstitutional, the Sixth Circuit explicitly embraced the reasoning advanced in an academic article that attacks virtually all ITCs in the nation. See Cuno Cert. App. 13, n.1 (citing W. Hellerstein & D. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 Cornell L. Rev. 789 (1996)).[6] The authors of that article understand the broad implication their theories will have, if adopted. By their own account, "[t]he constitutionality of the vast majority of income tax credits in this country cannot be persuasively defended." *Id.* at 818. Nor would the plaintiff/respondents' counsel in this case disagree, since Professor Enrich himself has written that the "typical ITC," which "allows a business to reduce its state income tax liability by a specified percentage of the cost of new in-state facilities or equipment acquired or placed in service during the year," will, in light of several factors he cites, "violate the Commerce Clause's antidiscrimination principle." P. Enrich, *Saving the States from Themselves:*

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[6] On the other hand, the Sixth Circuit expressly rejected the reasoning of those commentators who have argued that ITCs are not unconstitutional if they are equally available to in-state and out-of-state entities. See P. Tatarowicz & R. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 Vand. L. Rev. 879 (1986).

Commerce Clause Constraints on State Tax Incentives for Business, 110 Harv. L. Rev. 377, 434, 437 (1996).

Ohio respectfully submits that, these academic commentators' views notwithstanding, the Sixth Circuit's ITC ruling dramatically extends the Commerce Clause antidiscrimination principle beyond its prior—and proper—boundaries. But whether the decision below is correct or not, it merits review as it has, as those same commentators admit, the potential effect of prohibiting virtually any locational incentive adopted in the framework of a corporate franchise or income tax.

The prospect that courts will extinguish a sizeable body of state tax measures will both chill the effectiveness of offering such incentives (even outside the Sixth Circuit), and at the same time engender uncertainty about enforcing exemptions and credits already awarded. The dollar figures involved are staggering. As noted above, Ohio's $302 million in ITCs have attracted over $30 billion in new investment. According to Ohio Department of Taxation estimates, the average annual ITCs granted by just six states (California, Illinois, Massachusetts, Michigan, New York and Texas) amounts to $844 million per year, representing tens of billions of dollars annually in new plants, equipment and machinery. Moreover, as noted above, that also translates into thousands of jobs for citizens in these States. In short, both States and private businesses have a vast monetary and social welfare stake in the outcome here. The staggering impact of the decision counsels for immediate review, independent of what the outcome of that review may be.

These circumstances distinguish this petition from the usual claim that an appellate court has erred: in this case, the nature of the error inherently reaches beyond the boundaries of the judicial circuit to adversely affect the whole nation. Accordingly, this Court should not wait for further

percolation, but should instead grant the writ and furnish the nation with the clarity this issue demands.

C. Tax and economic development policies lie at the core of State sovereignty, and the decision below improperly interferes with that sovereign power.

Taxation and economic development are core sovereign functions that go to the heart of the State's ability to provide for the general welfare of its citizens. Indeed, the Court's own cases have acknowledged that the "taxation authority of state government" is "central to state sovereignty." *Dep't of Revenue v. ACF Indus.*, 510 U.S. 332, 345 (1994). And "[t]he power to tax is basic to the power of the State to exist." *Arkansas v. Farm Credit Servs.*, 520 U.S. 821, 826 (1997). Perhaps nowhere is the State's authority to structure its tax system more important than with regard to business development incentives such as those at issue here. Surely one of a State's core functions is promoting its citizens' welfare. New growth, new jobs, and new opportunities are central to that welfare. In short, the decision below attacks not one, but two, vital aspects of Ohio's sovereignty.

Of course, no one disputes that the State's sovereign powers must yield in the face of constitutional demands, but here, the court below erred in finding that Ohio had violated the Constitution. To start with, as demonstrated above, the court adopted a flawed view of the dormant Commerce Clause. But perhaps even more troubling, *the opinion below is wrong even under its own flawed constitutional view*. To the extent that the Sixth Circuit's approach distinguishes between a constitutional exemption and an unconstitutional tax credit based on whether the measure "reduces pre-existing [] tax liability," Cuno Cert. App. 15, its reasoning simply ignores two of the essential features of state corporate franchise and income taxes that are described above. First, the fact that the in-state tax base varies in proportion to the percentage of property, payroll and sales located in the state

means that a decision to invest in new manufacturing machinery and equipment outside the state typically has the effect of reducing the company's exposure to the state corporate franchise or income tax. That is so, because the property factor will decrease since a greater proportion of the corporation's property is located outside the state; and depending on the size of the out-of-state investment, that shift could "reduce pre-existing liabilities" in the taxing state. (The sales factor may also decrease.) In other words, state corporate franchise and income taxes typically create for interstate businesses an automatic incentive to locate outside the State in order to reduce tax exposure within the State. To a considerable (but not easily defined) degree, the ITC merely offsets the inherent incentive of corporate franchise and income taxes to locate outside the taxing state. Thus, the ITC potentially enhances, rather than decreases, the prospect for tax-neutral decision-making.

Moreover, this circumstance points to another defect in the lower court's determination that the ITC creates a "facial discrimination against interstate commerce." Presumably the cure for a "facial discrimination" is to eliminate, on the face of the statute, the distinction between in-state and out-of-state activity that is determined to be unconstitutional. But if Ohio passed a new ITC that made the credit available regardless of the location of new investment, that would plainly *overcompensate to a considerable degree* for the problem of "reducing pre-existing tax liabilities." That is so, because a business that chose to locate new facilities outside Ohio would enjoy an ITC that piggy-backs its own benefit on the inherent benefit of reducing exposure to the Ohio tax by reducing the Ohio property and sales factors.

The court's decision also proceeded from another flawed assumption. According to the court, the ITC was unconstitutional because it would decrease "existing tax liabilities." In fact, though, as corporate franchise taxes typically determine the in-state tax base to some degree by

applying an apportionment of property, payroll and sales to the interstate net worth or interstate income of the business, there will be many situations where the ITC does not "reduce existing tax liabilities," but merely offsets new tax obligations directly traceable to the new investment. For example, a corporation that in year one has no Ohio presence and pays no Ohio corporate franchise tax may face a decision in year two where to locate new investment. If it locates in Ohio, it exposes itself to Ohio corporate franchise tax for the first time. The ITC may in such a case operate simply to offset the newly incurred exposure to Ohio corporate franchise tax directly resulting from the new investment. Even under the Sixth Circuit's reasoning, the ITC would not violate the Commerce Clause in those situations. The decision below, however, makes no exception for such circumstances, broadly holding the ITC unconstitutional across the board.

For all these reasons, the Sixth Circuit stood on shaky ground at best in striking a state tax credit based upon the assertion that it might "reduce existing tax liabilities." As this Court has noted, Commerce Clause challenges to taxation involve a "delicate balancing of the national interest in free and open trade and a State's interest in exercising its taxing powers." *Westinghouse*, 466 U.S. at 402. Unfortunately, the decision below was neither delicate, nor balanced. And the profound implications of that decision for Ohio's sovereign right to control its own economic destiny, along with the unwarranted extension of this Court's precedent, and the confusion among lower courts on this issue all show the need for immediate review. Accordingly, Ohio respectfully, but urgently, requests the Court to grant Ohio's petition (and DaimlerChrysler's petition as well) and reverse the Sixth Circuit's judgment that the ITC is unconstitutional.

CONCLUSION

For the above reasons, the Petition should be granted.

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APPENDIX

Ohio Revised Code § 5733.33 Nonrefundable credit for purchase of new manufacturing machinery and equipment.

(A) As used in this section:

(1) "Manufacturing machinery and equipment" means engines and machinery, and tools and implements, of every kind used, or designed to be used, in refining and manufacturing.

(2) "New manufacturing machinery and equipment" means manufacturing machinery and equipment, the original use in this state of which commences with the taxpayer or with a partnership of which the taxpayer is a partner.

(3)(a) "Purchase" has the same meaning as in section 179(d)(2) of the Internal Revenue Code.

(b) Any purchase, for purposes of this section, is considered to occur at the time the agreement to acquire the property to be purchased becomes binding.

(c) Notwithstanding section 179(d) of the Internal Revenue Code, a taxpayer's direct or indirect acquisition of new manufacturing machinery and equipment is not purchased on or after July 1, 1995, if the taxpayer, or a person whose relationship to the taxpayer is described in subparagraphs (A), (B), or (C) of section 179(d)(2) of the Internal Revenue Code, had directly or indirectly entered into a binding agreement to acquire the property at any time prior to July 1, 1995.

(4) "Qualifying period" means the period that begins July 1, 1995, and ends December 31, 2000.

(5) "County average new manufacturing machinery and equipment investment" means either of the following:

(a) The average annual cost of new manufacturing machinery and equipment purchased for use in the county during baseline years, in the case of a taxpayer or partnership that was in existence for more than one year during baseline years.

(b) Zero, in the case of a taxpayer or partnership that was not in existence for more than one year during baseline years.

(6) "Partnership" includes a limited liability company formed under Chapter 1705 of the Revised Code or under the laws of any other state, provided that the company is not classified for federal income tax purposes as an association taxable as a corporation.

(7) "Partner" includes a member of a limited liability company formed under Chapter 1705 of the Revised Code or under the laws of any other state, provided that the company is not classified for federal income tax purposes as an association taxable as a corporation.

(8) "Distressed area" means either a municipal corporation that has a population of at least fifty thousand or a county that meets two of the following criteria of economic distress, or a municipal corporation the majority of the population of which is situated in such a county:

(a) Its average rate of unemployment, during the most recent five-year period for which data are available, is equal to at least one hundred twenty-five per cent of the average rate of unemployment for the United States for the same period;

(b) It has a per capita income equal to or below eighty per cent of the median county per capita income of the United States as determined by the most recently available figures from the United States census bureau;

(c)(i) In the case of a municipal corporation, at least twenty per cent of the residents have a total income for the most recent census year that is below the official poverty line;

(ii) In the case of a county, in intercensal years, the county has a ratio of transfer payment income to total county income equal to or greater than twenty-five per cent.

(9) "Eligible area" means a distressed area, a labor surplus area, an inner city area, or a situational distress area.

(10) "Inner city area" means, in a municipal corporation that has a population of at least one hundred thousand and does not meet the criteria of a labor surplus area or a distressed area, targeted investment areas established by the municipal corporation within its boundaries that are comprised of the most recent census block tracts that individually have at least twenty per cent of their population at or below the state poverty level or other census block tracts contiguous to such census block tracts.

(11) "Labor surplus area" means an area designated as a labor surplus area by the United States department of labor.

(12) "Official poverty line" has the same meaning as in division (A) of section 3923.51 of the Revised Code.

(13) "Situational distress area" means a county or a municipal corporation that has experienced or is experiencing a closing or downsizing of a major employer, that will adversely affect the county's or municipal corporation's economy. In order to be designated as a situational distress area for a period not to exceed thirty-six months, the county or municipal corporation may petition the director of development. The petition shall include written documentation that demonstrates all of the following adverse effects on the local economy:

(a) The number of jobs lost by the closing or downsizing;

(b) The impact that the job loss has on the county's or municipal corporation's unemployment rate as measured by the Ohio bureau of employment services;

(c) The annual payroll associated with the job loss;

(d) The amount of state and local taxes associated with the job loss;

(e) The impact that the closing or downsizing has on the suppliers located in the county or municipal corporation.

(14) "Cost" has the same meaning and limitation as in section 179(d)(3) of the Internal Revenue Code.

(15) "Baseline years" means:

(a) Calendar years 1992, 1993, and 1994, with regard to a credit claimed for the purchase during calendar year 1995, 1996, 1997, or 1998 of new manufacturing machinery and equipment;

(b) Calendar years 1993, 1994, and 1995, with regard to a credit claimed for the purchase during calendar year 1999 of new manufacturing machinery and equipment;

(c) Calendar years 1994, 1995, and 1996, with regard to a credit claimed for the purchase during calendar year 2000 of new manufacturing machinery and equipment.

(B)(1) A nonrefundable credit is allowed against the tax imposed by section 5733.06 of the Revised Code for a taxpayer that purchases new manufacturing machinery and equipment during the qualifying period, provided that the new manufacturing machinery and equipment are installed in this state no later than December 31, 2001.

(2) The credit is also available to a taxpayer that is a partner in a partnership that purchases new manufacturing machinery and equipment during the qualifying period,

provided that the partnership installs the new manufacturing machinery and equipment in this state no later than December 31, 2001. The taxpayer shall determine the credit amount as provided in division (H) of this section.

(3)(a) Except as otherwise provided in division (B)(3)(b) of this section, a credit may be claimed under this section in excess of one million dollars only if the cost of all manufacturing machinery and equipment owned in this state by the taxpayer claiming the credit on the last day of the calendar year exceeds the cost of all manufacturing machinery and equipment owned in this state by the taxpayer on the first day of that calendar year.

As used in division (B)(3)(a) of this section, "calendar year" means the calendar year in which the machinery and equipment for which the credit is claimed was purchased.

(b) Division (B)(3)(a) of this section does not apply if the taxpayer claiming the credit applies for and is issued a waiver of the requirement of that division. A taxpayer may apply to the director of the department of development for such a waiver in the manner prescribed by the director, and the director may issue such a waiver if the director determines that granting the credit is necessary to increase or retain employees in this state, and that the credit has not caused relocation of manufacturing machinery and equipment among counties within this state for the primary purpose of qualifying for the credit.

(C)(1) Except as otherwise provided in division (C)(2) of this section, the credit amount is equal to seven and one-half per cent of the excess of the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in a county over the county average new manufacturing machinery and equipment investment for that county.

(2) As used in division (C)(2) of this section, "county excess" means the taxpayer's excess cost for a county as computed under division (C)(1) of this section.

For a taxpayer with a county excess, whose purchases included purchases for use in any eligible area in the county, the credit amount is equal to thirteen and one-half per cent of the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in the eligible areas in the county, provided that the cost subject to the thirteen and one-half per cent rate shall not exceed the county excess. If the county excess is greater than the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in eligible areas in the county, the credit amount also shall include an amount equal to seven and one-half per cent of the amount of the difference.

(3) If a taxpayer is allowed a credit for purchases of new manufacturing machinery and equipment in more than one county or eligible area, it shall aggregate the amount of those credits each year.

(4) The taxpayer shall claim one-seventh of the credit amount for the tax year immediately following the calendar year in which the new manufacturing machinery and equipment is purchased for use in the county by the taxpayer or partnership. One-seventh of the taxpayer credit amount is allowed for each of the six ensuing tax years. Except for carried-forward amounts, the taxpayer is not allowed any credit amount remaining if the new manufacturing machinery and equipment is sold by the taxpayer or partnership or is transferred by the taxpayer or partnership out of the county before the end of the seven-year period.

(5)(a) A taxpayer that acquires manufacturing machinery and equipment as a result of a merger with the taxpayer with whom commenced the original use in this state of the

manufacturing machinery and equipment, or with a taxpayer that was a partner in a partnership with whom commenced the original use in this state of the manufacturing machinery and equipment, is entitled to any remaining or carried-forward credit amounts to which the taxpayer was entitled.

(b) A taxpayer that enters into an agreement under division (C)(3) of section 5709.62 of the Revised Code and that acquires manufacturing machinery or equipment as a result of purchasing a large manufacturing facility, as defined in section 5709.61 of the Revised Code, from another taxpayer with whom commenced the original use in this state of the manufacturing machinery or equipment, and that operates the large manufacturing facility so purchased, is entitled to any remaining or carried-forward credit amounts to which the other taxpayer who sold the facility would have been entitled under this section had the other taxpayer not sold the manufacturing facility or equipment.

(c) New manufacturing machinery and equipment is not considered sold if a pass-through entity transfers to another pass-through entity substantially all of its assets as part of a plan of reorganization under which substantially all gain and loss is not recognized by the pass-through entity that is transferring the new manufacturing machinery and equipment to the transferee and under which the transferee's basis in the new manufacturing machinery and equipment is determined, in whole or in part, by reference to the basis of the pass-through entity which transferred the new manufacturing machinery and equipment to the transferee.

(d) Division (C)(5) of this section shall apply only if the acquiring taxpayer or transferee does not sell the new manufacturing machinery and equipment or transfer the new manufacturing machinery and equipment out of the county before the end of the seven-year period to which division (C)(4) of this section refers.

(e) Division (C)(5)(b) of this section applies only to the extent that the taxpayer that sold the manufacturing machinery or equipment, upon request, timely provides to the tax commissioner any information that the tax commissioner considers to be necessary to ascertain any remaining or carried-forward amounts to which the taxpayer that sold the facility would have been entitled under this section had the taxpayer not sold the manufacturing machinery or equipment. Nothing in division (C)(5)(b) or (e) of this section shall be construed to allow a taxpayer to claim any credit amount with respect to the acquired manufacturing machinery or equipment that is greater than the amount that would have been available to the other taxpayer that sold the manufacturing machinery or equipment had the other taxpayer not sold the manufacturing machinery or equipment.

(D) The taxpayer shall claim the credit in the order required under section 5733.98 of the Revised Code. Each year, any credit amount in excess of the tax due under section 5733.06 of the Revised Code after allowing for any other credits that precede the credit under this section in that order may be carried forward for three tax years.

(E) A taxpayer purchasing new manufacturing machinery and equipment and intending to claim the credit shall file, with the department of development, a notice of intent to claim the credit on a form prescribed by the department of development. The department of development shall inform the tax commissioner of the notice of intent to claim the credit.

(F) The director of development shall annually certify, by the first day of January of each year during the qualifying period, the eligible areas for the tax credit for the calendar year that includes that first day of January. The director shall send a copy of the certification to the tax commissioner.

(G) New manufacturing machinery and equipment for which a taxpayer claims the credit under section 5733.31, 5733.311 [5733.31.1], 5747.26, or 5747.261 [5747.26.1] of the Revised Code shall not be considered new manufacturing machinery and equipment for purposes of the credit under this section.

(H)(1) With regard to a taxpayer that is a partner in a partnership, the county average new manufacturing machinery and equipment investment shall be determined based on the number of years, if any, the partnership was in existence during baseline years. In determining the county average new manufacturing machinery and equipment investment, the excess of the cost of new manufacturing machinery and equipment purchased during the calendar year, and all other amounts necessary to calculate the credit allowed by this section, the taxpayer shall include the taxpayer's distributive share of the cost of new manufacturing machinery and equipment purchased by a partnership in which the corporation had a direct or indirect investment during the calendar year prior to the first day of a tax year for which the taxpayer is claiming the credit. These determinations and calculations shall be made for the taxpayer's calendar year during which the partnership made the purchase.

(2) Nothing in this section shall be construed to limit or disallow pass-through treatment of a pass-through entity's income, deductions, credits, or other amounts necessary to compute the tax imposed by section 5733.06 of the Revised Code and the credits allowed by this chapter.

(2) (2)

Nos. 04-1704 and 04-1724

Supreme Court, U.S.
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In The Supreme Court of the United States

DAIMLERCHRYSLER CORP., et al.,

Petitioners,

v.

CHARLOTTE CUNO, et al.,

Respondents.

AND

WILLIAM W. WILKINS, Tax Commissioner etc., et al.,

Petitioners,

v.

CHARLOTTE CUNO, et al.,

Respondents.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

RESPONDENTS' BRIEF IN RESPONSE TO PETITIONS FOR *CERTIORARI*

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QUESTION PRESENTED

Was the Sixth Circuit correct in finding that a state investment tax credit, which provides tax benefits only to those taxpayers who locate new capital investments in the state, violates the Commerce Clause's prohibition on discriminatory tax provisions because the law provides preferential tax treatment that favors in-state economic activity?

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INTRODUCTION

These petitions address one portion of a case in which the Sixth Circuit reviewed the constitutionality of two different tax incentives authorized by the State of Ohio and used to encourage DaimlerChrysler Corporation to locate a new manufacturing facility in Ohio. The Sixth Circuit found that Ohio's investment tax credit ("ITC") violated the Commerce Clause, while concluding that its conditional exemption from personal property taxes did not.

Like the State of Ohio, Respondents believe it would be advisable for the Court to review both aspects of this important case, and therefore, we do not oppose the instant Petitions. The two tax incentives challenged in this litigation are both designed to offer preferential treatment to corporate taxpayers who choose to locate substantial new investments in the state of Ohio. Both discriminate, although in somewhat different ways, in favor of businesses that commit to expanded economic activity in Ohio and against those who do not make such commitments. Thus, the two aspects of the case raise closely related questions about the scope of the Commerce Clause's prohibition on discriminatory state tax provisions, and review of the two aspects together would allow the Court to shed useful light on the proper application of the Commerce Clause in both contexts.

Respondents agree, in particular, with Petitioners' assertions concerning the great practical importance of the outcome of this case. Tax incentives similar to Ohio's ITC and its conditional property tax exemptions are deployed by virtually every state, and the impacts on state and local revenues and on the distribution of the costs of government among different classes of taxpayers are dramatic.

Moreover, the proliferation of state and local tax incentives designed to shape business location decisions has gone a long way to fragment the "national 'common market,'" *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 350 (1977), which the Commerce Clause seeks to preserve.

With regard to the merits of the case, Respondents disagree, not only with Petitioners' view that the Sixth Circuit's decision concerning Ohio's ITC was mistaken, but also with Petitioners' claims about the novelty and complexity of the issues presented. Indeed, as we discuss below, the Sixth Circuit's analysis of Ohio's ITC follows straightforwardly from a long line of this Court's decisions striking down discriminatory tax provisions that provide "a direct commercial advantage to local business." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977). Nonetheless, particularly in light of the need to review the Sixth Circuit's problematic application of Commerce Clause principles to Ohio's conditional property tax exemption, *see* Petition for Writ of Certiorari in No. 04-1407 ("Cuno Petition") at 9-16, Respondents agree that clarification by this Court of the full set of issues presented by this case would advance important Commerce Clause goals.

STATEMENT OF THE CASE

Respondents generally concur with Petitioners' Statements of the Case. Only a few points warrant brief clarification.

First, the Petitioners in 04-1724 ("State Pet.") aver, without any citation, that investment tax credits "have

previously been understood as . . . acceptable." State Pet. at 3. While it is certainly true that such credits have been widely adopted among the States, it is likewise the case that the Sixth Circuit's ruling, finding such credits in violation of the Commerce Clause, had long been anticipated by many students of state and local tax policy. *See, e.g.*, Walter Hellerstein & Daniel T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 817-18 (1996); Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Restraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 434-37 (1996); Robert D. Plattner, *State Business Tax Incentives: Are They Vulnerable to Constitutional Attack*, 2000 STATE TAX TODAY 128-19 (July 3, 2000); *cf. State Tax Advisory Board Focuses on High Court Developments, Nexus, and More During October 1995 Roundtable*, 56 ST. TAX. REP. (CCH) No. 49, at 8, 9-10 (Dec. 4, 1995) (reporting the recognition by a panel of leading state tax practitioners of the Commerce Clause difficulties facing business tax incentives). The Sixth Circuit's decision, while significant in its impact, was far from surprising or revolutionary.

Second, the State Petitioners, in explaining the methodology employed in calculating the portion of a multistate business's income that is subject to Ohio tax, describe Ohio's three-factor formula as reflecting the common approach characterized by this Court as "something of a benchmark." State Pet. at 8 (quoting *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983)). But Petitioners fail to mention an important respect in which Ohio's approach departs from the "benchmark" methodology, which equally weights the three factors (property, payroll, and sales). Ohio's approach, by contrast,

assigns the sales factor three times the weight of each of the other factors. *See* Ohio Rev. Code § 5733.05(B)(2). The consequence of this triple weighting of the sales factor is that the attribution of a taxpayer's income to Ohio is determined predominantly on the basis of where its sales are located, a factor unlikely to be significantly affected by a plant location decision. Thus, contrary to Petitioners' speculations, there is likely to be at most a quite modest increase in a taxpayer's Ohio tax liability due to location of a new plant in the state, an increase far smaller than the tax reduction due to Ohio's ITC. And the scale of any tax increase because of the new investment will be still smaller in a case like the present one where the new plant is a replacement for an existing facility in Ohio.

Finally, it is noteworthy that both Petitioners, in their descriptions of the Sixth Circuit's decision, omit any reference to the centerpiece of the court's explanation of how Ohio's ITC violates the Commerce Clause by discriminating between in-state and out-of-state economic activity. Instead, both Petitions focus on a more general phrase (concerning measures whose "economic effect . . . is to encourage further investment in-state at the expense of development in other states") used at one point in the court's discussion, in an effort to suggest that the Sixth Circuit's approach is overbroad. *See* Petition of DaimlerChrysler Corp., No. 04-1704, at 6; State Pet. at 13. Overlooked is the court's careful description of the specifically discriminatory features that render Ohio's ITC unconstitutional, DaimlerChrysler Pet. App. at 6a:

> Specifically, any corporation currently doing business in Ohio, and therefore paying the state's

> corporate franchise tax in Ohio, can reduce its existing tax liability by locating significant new machinery and equipment within the state, but it will receive no such reduction in tax liability if it locates a comparable plant and equipment elsewhere. Moreover, as between two businesses, otherwise similarly situated and each subject to Ohio taxation, the business that chooses to expand its local presence will enjoy a reduced tax burden, based directly on its new in-state investment, while a competitor that invests out-of-state will face a comparatively higher tax burden because it will be ineligible for any credit against its Ohio tax.

The question addressed by the Sixth Circuit, and the important question to be reviewed by this Court, is whether tax provisions with such an explicitly discriminatory design and effect can withstand Commerce Clause scrutiny.

DISCUSSION

A. The decision below involves a recurring issue of great practical importance.

Respondents concur that the issues raised by this case are of broad national importance, because they will apply to a range of comparable business tax incentives offered by many states. Indeed, it has never been Respondents' intention to single out Ohio's incentive programs as distinctively problematic, nor to place Ohio (or the Sixth Circuit states) at a competitive disadvantage vis a vis the rest of the nation. Instead, Respondents anticipate that a clear statement of the unconstitutionality of discriminatory state tax incentives will free all the states from the

necessity of engaging in an escalating competition over incentives that deprives all of them of needed revenues, while gaining a meaningful competitive advantage for none.

At present, as Petitioners document, investment tax credits, closely comparable to the Ohio program struck down by the Sixth Circuit, are deployed by a substantial majority of the states, and virtually every state with a tax on corporate income offers some variety of credit based on the in-state location of specific forms of economic activity. *See* State Pet. at 22 n.5 (thirty-seven states have ITCs); DaimlerChrysler Pet. at 8-9. Likewise, property tax exemptions that are conditioned on in-state economic activity beyond the investment in the exempted property itself, like the Ohio provision challenged in the Cuno Petition, are an increasingly common feature of state tax systems. *See* Cuno Pet. at 16-17.

Nationally, the impact of these tax breaks on state and local revenues are dramatic. As the State Petitioners observe, the annual cost of ITCs in a handful of states for which estimates were available comes to $844 million, *see* State Pet. at 25, while it is estimated that the annual costs of just one state's property tax exemption program will exceed $400 million by 2008, *see* TEXAS TAX EXPENDITURE AND INCIDENCE REPORT 2005-2007, Table 1 at 36 (2003). The inevitable result is a significant shift of the costs of state and local government to other classes of taxpayers, like Respondents here, and a substantial reduction in states' and localities' ability to deliver important public services. *See, e.g.*, Peter Fisher, *Tax Incentives and the Disappearing State Corporate Income Tax*, 2002 STATE TAX TODAY 42-1 (March 4, 2002); Robert Tomsho, *In Toledo, A*